No. 12147

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRANCIS F. QUITTNER, as Trustee in Bankruptcy of the Estate of Alvera Gordon Jones, doing business as LE-ROY GORDON BEAUTY SALONS,

Appellee,

vs.

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, a National Banking Association,

Appellant.

APPELLEE'S REPLY BRIEF.

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Appellee deems it necessary to call to the Court's attention additional facts adduced by the evidence, although it will be necessary for this Court to read the entire transcript as Appellee does not desire to repeat all the evidence.

Relating to the testimony of Robert R. Duval:

When Mrs. Jones presented Defendant with a statement, Plaintiff's Exhibit 2, in September, 1947, and Appellant looked at same giving it back to Mrs. Jones, Appellant did not ask her for a copy of said statement [R. 49]; nor does he remember comparing that statement with the statement dated March, 1947, which was in Appellant's file [R. 94]; that Appellant did not notice that

the tax claims as shown in the statement of August 31, 1947, were as large if not larger than they had been six months previously nor could he remember noticing that the accounts payable were substantially larger in the statement of August 31, 1947 [R. 94]; neither did Appellant ever go to look at the stores or the equipment in any of the stores; nor did Appellant know the condition of the equipment [R. 50].

The Appellee would also like to call to the Court's attention the fact that after the note was renewed on April 30, 1947, and on July 30, 1947, the note then became due on September 30, 1947; that it was not renewed by the Defendant on that date, but was in default from September 30, 1947, until December 6, 1947 [R. 40-21], when it was renewed on a *demand* basis with a ninety day limit.

The evidence further showed that the bankrupt's summary of debts and assets as set forth in her schedules filed in bankruptcy, showed debts in the sum of $38,442.36 and assets in the sum of $9,474.47 [R. 78]. The report of the appraiser of said bankrupt estate filed on March 27, 1948, indicated an appraisal of the real and personal property of the bankrupt set out in the schedules in the sum of $9,930.00 [R. 26]. The order confirming sale of the bankrupt estate's beauty parlors, merchandise and fixtures set forth that the same was sold for $5,100.00 [R. 27]. The testimony of Mrs. Jones was that her assets in November and December, 1947 and January, 1948, were substantially the same as they were in March, 1948 [R. 81].

ARGUMENT.

POINT I.

Appellee Sustained the Burden of Proof Which Was Upon Him to Prove Every Element of a Preference Under the Bankruptcy Act.

Appellee agrees that in order for the trustee to avoid a preference, the creditor must have had reasonable cause to believe that the debtor was insolvent at the time of the transfer.

Appellee further agrees that the burden of proving the existence of all essential elements is upon the trustee seeking to avoid the transfer.

With respect to Appellant's contention that Appellee did not sustain his burden of proof requiring him to establish that Appellant had reasonable grounds to believe that the bankrupt was insolvent at the time of the transfer, Appellee respectfully submits that Appellant did sustain such burden.

The evidence of Mr. Duval, manager of the Branch Bank of Appellant, showed that the last financial statement obtained by the Appellant was on March 31, 1947, that Appellant did not receive any financial statements after said March 31, 1947 [R. 38-39]; that subsequently some time during the summer of 1947, Appellant saw a statement which bankrupt presented to Appellant and which was taken back by the bankrupt, and that said statement showed a net worth, but that Appellant could not recall the amount thereof [R. 39]. The Appellant never saw any further statement or figures relative to the bankrupt's business after the statement of August 31, 1947 [R. 89]. The evidence of Mr. Duval also showed that he

did not ask for a copy of the statement of August 31, 1947 [R. 49]; that he had never seen the stores or their equipment, nor did he know the condition of the equipment [R. 50], neither could he remember comparing the statement of August 31, 1947, with the statement of March 31, 1947, which he had in his file [R. 94]. There was no evidence to show that he requested any further statement from the bankrupt from September 1947, until January 1948, when the note was finally paid, that Appellant did not notice that the tax claims as shown in the statement of August 31, 1947, were as large if not larger than they had been six months previously; nor could he remember noticing that the accounts payable were substantially larger in the statement of August 31, 1947 [R. 94], nor was there any evidence to show that Appellant had examined or analyzed the statement at all beyond seeing that it showed a net worth. Did the Defendant exercise the care of a reasonably prudent businessman in view of the knowledge which he had that the debtor had not been able to pay her note and that he had renewed said note three times? Was this the action of a banker, or a businessman trained in the intricacies of credit? The only logical explanation for his conduct under the circumstances is that he was aware that her assets were overinflated and that he knew that the request for a statement was merely a perfunctory gesture; otherwise, it appears from the facts adduced by Defendant's testimony that he was grossly negligent in ascertaining the true state of his debtor's affairs.

With reference to the overdrafts allowed by the Defendant, the evidence showed that there were overdrafts of $2,319.33 on October 1, 1947; $4,059.82 on October 2, 1947 and $5,100.42 on October 3, 1947, and that the

overdrafts continued in substantial amounts until October 11, 1947, when a credit balance of $106.22 was shown, that on October 14, 1947, there was another overdraft of $393.33 and that there were no overdrafts during the balance of October and during the month of November, 1947 [R. 47] and only two overdrafts in December, 1947, one of $541.72 on December 8, 1947, and one $13.00 on December 11, 1947 [R. 93]. The heavy overdrafts during October 1947, must have indicated to the Defendant the worsening condition of the debtor's financial status, and although Appellant contends that overdrafts were allowed in the early part of 1947 as well as in the latter part of the year, the record does not disclose the amounts of such early overdrafts. Why did the heavy overdrafts stop after October 11, 1947? Was the debtor told that they would not be honored? The Appellant's answer is that the debtor had been told that her overdrafts would not be honored. What other explanation would logically explain the sudden cessation of the large overdrafts after October 11, 1947? If the operation of the bankrupt's shops in regard to their banking procedure was such that overdrafts were customary, as contended by the Appellant, why weren't there any overdrafts in November and only two overdrafts in December? Why wasn't the note renewed until December 6, 1947?

Appellant asks the Court "Could it be reasonably said that if Appellant felt that the bankrupt would be unable to pay its note and would be unable to make good the overdrafts, Appellant would have permitted these things

to go on?" The evidence showed that the overdrafts did not go on, that the note was not renewed on September 30, 1947, and was in default until December 6, 1947, and that the bank balance was approximately $100.00. The evidence further disclosed that the bankrupt was not able to pay the note, otherwise, she would not have taken one year to pay a ninety day note [R. 35-36-37].

Appellant contends that "The Appellee was not able to establish any evidence on the part of Appellant that the bankrupt was in any financial difficulty other than that she was short of working capital, and that a few of her beauty salons were not making money and she was advised to sell them." However, the testimony of the bankrupt, Mrs. Jones, disclosed that she had told Appellant that she was having financial difficulties and that Appellant knew that she was losing money right along [R. 70], that she felt that there was only one thing left to do and that was to go into receivership [R. 75-76], and that her understanding with the Appellant was that when she did sell the stores that she would take care of the loan and would do so as quickly as she could [R. 73].

Appellee respectfully submits that bankrupt was having financial difficulties; that she was short of working capital; that it was necessary to sell some of her beauty shops; that she had consistently large overdrafts during the month of October, 1947; that her note was renewed three times by the Appellant; that her note was in default from September, 1947 until December 6, 1947; that when Appellant was shown a statement which indicated a net

worth, he did not compare the statement with a copy of a prior statement which he had in his files, he did not analyze the statement, he failed to note or question the qualifications set forth by the accountants thereon or did he question the value of the assets, he did not ask for a copy of same for his records, nor did Appellant ask for any further statements after September, 1947, regarding the debtor's financial condition. It is Appellee's contention that the aforementioned facts should have given notice to the Appellant that the debtor was in serious financial difficulty and that if the Appellant disregarded these obvious warnings of the debtor's insolvent condition, it was negligent in not making such further inquiry into her affairs as would have disclosed the full extent of the true state of her affairs.

In the case of *Levy v. Weinberg and Holman Inc.* (C. C. A., 2nd Cir.), 20 Fed. Rep. 2d 565, the Court stated that a creditor may not wilfully close his eyes that he might remain in ignorance of his debtor's condition.

In the case of *Pender v. Chatham Phenix National Bank and Trust Co.* (C. C. A., 2nd Cir.), 58 Fed. Rep. 2d 968, the Court stated that in preference cases, notice of facts which would incite a man of ordinary prudence to an inquiry under similar circumstances is notice of all the facts which a reasonably diligent inquiry would disclose.

In the case of *Canright v. General Finance Corp.* (East Dist. of Ill.), 35 Fed. Supp. 841, the Court states:

> "Defendant was charged with what it learned or should have learned as a reasonably prudent business-

man, through its representatives . . . Failure to investigate will afford no excuse when the creditor's knowledge and information are sufficient to have put an ordinary businessman on inquiry. It is not a question of actual belief; rather, the test is the belief that ought reasonably to be entertained under the facts known, the inference which an ordinarily intelligent businessman would draw from the facts which he would discover if he made inquiry. Defendant could not close his eyes to known or obvious facts, or facts which it could have ascertained, by making the inquiry of a reasonably prudent businessman. It was bound to make real inquiry, that is, such an investigation as a reasonably prudent and honest businessman would have made under the circumstances known."

In the case of *Boston National Bank v. Early,* 17 Fed. Rep. 2d 691, the Court stated:

"The president of the bank knew upon September 30, 1924 that the balances of the bankrupt were far below those required. The original loan had been carried for more than two years, the notes given for it being renewed from time to time, and upon this date, the bank was unwilling to renew the note of $3,500.00, which then fell due, without assurances that larger balances would be maintained by the bankrupt. The statement of the bankrupt's account showed decreasing deposits after that date. Checks were held as overdrafts in order to secure payment of the note. These facts should have put creditors upon inquiry, which would have showed that the company was bankrupt."

POINT II.

The Evidence Sustained the Finding [Finding IX, R. 9] That Appellant Was in Possession of Sufficient Facts Concerning the Bankrupt's Business as Would Give It Reasonable Cause to Believe That the Bankrupt Was Insolvent.

The Appellee respectfully submits that there was substantial evidence to sustain Finding IX [R. 9] that Appellant was in possession of sufficient facts concerning the bankrupt's business as would give it reasonable cause to believe that the bankrupt was insolvent. Appellee further submits that the trial court is the sole trier of the facts and found from all of the facts from the evidence presented that Appellant had reasonable cause to believe that the bankrupt was insolvent.

Appellant has cited cases that a mere suspicion is not sufficient to show that the creditor had reasonable cause to believe. In the case at bar, Appellee respectfully contends that the evidence disclosed a set of circumstances which would give an ordinarily prudent businessman more than a mere suspicion that the debtor was insolvent; such facts should certainly give a prudent businessman a reasonable cause to believe, and if he failed to realize that such facts showed the insolvency of the debtor or that the situation called for further inquiry into his debtor's affairs, he must be accused of wilfully closing his eyes.

In the case of *In re Eggert* (C. C. A., 7th Cir.), 102 Fed. Rep. 735, the Court stated that if facts and circumstances with respect to the debtor's financial condition are brought home to the creditor such as would put an ordinarily prudent businessman upon inquiry, the creditor is

chargeable with knowledge of the facts which such inquiry should reasonably be expected to disclose.

In the case of *Prudential Ins. Co. of America v. Nelson* (C. C. A., 6th Cir.), 36 Amer. Bankruptcy Rep. (N. S.) 993, 96 Fed. Rep. 2d 487, the Court states:

> "While it is true that mere suspicion of insolvency or preferential effect is not enough to establish the voidability of a transfer, yet neither are circumstances which carry absolute conviction of insolvency the test of its infirmity . . . if reasonable cause to believe a transferor insolvent and his transfer preferential in effect must wait upon complete audit and appraisal of a bankrupt's affairs, preferential transfers would rarely exist and the statutory protection to creditors be unavailing."

It is respectfully urged that Appellant was aware of such various facts: the inability of the debtor to pay the ninety day note until one year had elapsed, the heavy overdrafts of the bankrupt, the financial difficulties of the bankrupt, the necessity of the bankrupt to sell a store in order to pay the note, the bankrupt's operating losses, and the bankrupt's discussion as to receivership. In view of these obvious danger signals, why didn't the Appellant ask for additional financial statements after the one it saw in September, 1947, or why didn't it investigate further into the status of the debtor? Is this the logical action of a bank, an institution which is noted for its careful handling of credit matters, the staunch rock of the business community? It is obvious that Appellant either already knew that insolvency existed or else was grossly careless in not pursuing further inquiry. The Appellee respectfully contends that if the Appellant saw fit to close its eyes to the obvious, to sit back and not make further

inquiry into a situation which, at the least, called for additional investigation, then the Appellant was negligent, and it cannot assert such negligence in support of its contention that it did not have reasonable cause to believe the debtor was insolvent.

POINT III.

The Evidence Sustained the Finding That at the Time of the Payment to Defendant Made by Bankrupt the Fair Valuation of the Aggregate of Her Property Was Not Sufficient in Amounts to Pay Her Debt.

Since the Appellant has not seen fit to introduce argument on Point III of Appellant's Statement of Points upon which it intends to rely on appeal, the Appellee will forego argument on this point, except to refer to the evidence which showed that the bankrupt's Summary of Debts and Assets, as set forth in her schedules filed in bankruptcy on March 26, 1948, disclosed debts amounting to $38,442.36 and assets amounting to $9,474.47 [R. 78]; that the report of the appraiser filed on March 27, 1948, indicated that his appraisal of the real and personal property belonging to the estate of the bankrupt was in the sum of $9,930.00 [R. 81]; and that the Order Confirming Sale of the bankrupt's beauty shops together with the inventory of merchandise and fixtures showed that said property was sold for the sum of $5,100.00 [R. 80]; that the testimony of Mrs. Jones was that her assets in November and December 1947, and January 1948, were substantially the same as they were in March, 1948 [R. 81]; all of which indicates beyond question of doubt that the bankrupt was insolvent.

Conclusion.

The Appellee respectfully submits that he sustained the burden of the proof; that there is substantial evidence to sustain the finding of the Court, Finding IX, that prior to and at the time of the payments or transfers, said Appellant was in possession of such facts concerning the bankrupt's business as would give it reasonable cause to believe that the said bankrupt was insolvent; and that the judgment of the District Court should be affirmed.

Respectfully submitted,

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